BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CHANTICLEER INVESTMENT COMPANY)

Appearances:

For Appellant: Robert W. Stedman
Attorney at Law

For Respondent: Richard A. Watson
Counsel

OPINION

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Chanticleer Investment Company, as assumer and/or transferee of Columbia Convalescent Home, against proposed assessments of additional franchise tax in the amounts of $828.01, $1,716.99, $1,747.51, and $1,719.37 for the income years ended March 31, 1967, 1968, 1969, and 1970, respectively. Respondent concedes, as explained below, that if its position is sustained appellant will be entitled to partially offsetting refunds of $698.00, $800.00, and $841.09 for the income years ended March 31, 1968, 1969, and 1970, respectively.

The primary issue is whether appellant and its wholly owned subsidiary were entitled to file consolidated franchise tax returns combining their income and deductions.

Prior to January 1, 1966, Columbia Convalescent Home, a California corporation, hereafter called Columbia, operated a convalescent home in Long Reach, California. On that date, Columbia, which held a long-term lease of the premises, sublet the facilities. All of Columbia's income during the years in question consisted of the rental proceeds. On or about April 1, 1966, appellant, also a California corporation, acquired all of Columbia's capital stock. Appellant's entire income during the appeal years consisted of dividends paid by Columbia. Its expenses, during the same period, consisted primarily of interest on indebtedness, incurred in acquiring Columbia's stock. During the years in question both corporations conducted activities exclusively within this state.

On June 30, 1970, Columbia was completely liquidated and all of its assets, subject to liabilities, were transferred to appellant. Columbia was formally dissolved on September 21, 1970. Columbia's stock had been pledged to secure the indebtedness incurred when the stock was purchased. During 1970, however, the creditors allowed liquidation, accepting as security a deed of trust on the convalescent home facilities.

For each of the income years in question, appellant filed a franchise tax return combining its income and deduction-s with those of Columbia. It deducted the intercompany dividends received from Columbia, the above mentioned interest expense and other small expenses it incurred, and paid tax on the combined net income.

On the basis that neither corporation engaged in business outside this state, respondent determined that they were not entitled to file a consolidated or combinedreturn. Consequently, respondent computed the income of each corporation separately. All of appellant's income was found to be deductible under section 24402 of the Revenue and Taxation Code, which allows a deduction for dividends declared from income included in the measure of the tax imposed on the declaring corporation. Since no tax was due from appellant, respondent has proposed to grant refunds to it in the amounts stated above. However, inasmuch as appellant's expenses were not allowed as offsets against Columbia's rental income, Columbia's income -was increased, giving rise to the proposed assessments against appellant

as assumer of the liabilities or transferee of all of Columbia's assets.

Appellant explains that a purchase of Columbia's assets was intended, with the stock purchase an interim measure, the dual corporate setup being merely a security device to accommodate others. Appellant claims that since its sole purpose was to hold the stock and pay the debt incurred to purchase the stock, and because its entire existence was "dependent" on the conduct by Columbia of its rental business, there was a joint endeavor to conduct a single enterprise, i. e. , an intrastate "unitary" business, entitling the corporations to file consolidated or combined returns. Appellant principally relies upon section 25104 of the Revenue and Taxation Code but also mentions section 25102 in contending that respondent abused its discretion in not permitting the filing of such returns.

Section 25104, insofar as relevant, provides for consolidated reporting by parent and subsidiary corporations showing their combined net income and assessing the tax against either upon that basis where required by the Franchise Tax Board, if the Board determines it to be necessary to clearly reflect the net income earned by a corporation from business done in this state.

Section 25102, insofar as pertinent, provides that in the case of two or more "persons" owned by the same interests, the Franchise Tax Board may permit or require the filing of a combined report, and impose the tax due as though the combined net income was that of one person, if the Franchise Tax Board determines that this is necessary in order to reflect the proper income.

It is true that where two or more corporations are engaged in an interstate unitary business with part of the income derived from sources within this state, a combined report is required which consolidates their net income from the business. Thereafter, formula allocation is required to determine the net income derived from California sources by any corporation subject to the tax. (Rev. & Tax. Code, § 25101; Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P. 2d 16].) It has been held that a business is unitary when the operations within this state contribute to or are dependent upon the operations outside California. (Edison California Stores, Inc. v. McColgan, supra; Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P. 2d 33]; Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P. 2d 40].)

We agree with respondent, however, that prior decisions uphold its view that corporations engaged solely in intrastate business have no right to file a combined report consolidating their net incomes merely because they are carrying on what would be regarded as a unitary business if it were an interstate operation. (Appeals of Pacific Coast Properties, Inc., et al., Cal. St. Bd. of Equal., Nov. 20, 1968; see also Appeals of Bret Harte Inn, Inc., et al., Cal. St. Bd. of Equal., Feb. 18, 1970; Appeal of Kim Lighting and Mfg. Co., Inc., Cal. St. Bd. of Equal., June 2, 1969.) These decisions were buttressed by the appellate court's determination in Handlery v. Franchise Tax Board, 26 Cal. App. 3d 970 [103 Cal. Rptr. 465], which also held that the "unitary business" concept is applicable only with respect to interstate operations. Consequently, corporations engaged solely in intrastate business had no right to file combined reports under section 25102 and be treated as part of a "unitary business" even though they would have been considered as such had the business activity been interstate. The court referred to section 25102 as a sort of statutory catchall designed to permit the Franchise Tax Board, when found necessary to assure the state its proper revenue, to allow combined returns or otherwise to distribute or apportion or allocate income between "persons" whether their operations be interstate or intrastate or both.

While this court decision did not expressly consider the effect of section 25104, its reasoning was equally applicable to any claim that consolidated reporting would be allowed under that provision. Furthermore, section 25104 does not provide any authority for the submission of a consolidated report by a group of qualifying corporations. Rather, authority is given solely to the Franchise Tax Board to require such a report when that board determines it to be necessary to clearly reflect net income. (Appeals of Pacific Coast Properties, Inc., et al., supra.)

Appellant relies on the Appeal of Sudden and Christenson, Inc., decided by this board on January 5, 1961, and on Franchise Tax Board Legal Ruling 241, October 28, 1959, as supporting an intrastate "unitary" business concept, giving the right to file consolidated or combined returns. Careful analysis of those two authorities indicates, however, that they were concerned with interstate multicorporate activities when using the term "unitary."

Respondent also contends that even if appellant and its subsidiary were entitled to file consolidated or combined returns, appellant's expenses would be nondeductible. Respondent relies upon section 24425 of the Revenue and Taxation Code which disallows a deduction for any amount otherwise allowable which is allocable to income not included in the measure of the tax. Respondent points out that since all of appellant's income was deductible, its expenses would be nondeductible pursuant to section 24425. Having concluded that the filing of consolidated or combined returns was not improperly denied, it is unnecessary for us to consider this additional contention.

Accordingly, we conclude that respondent's action in this matter must be sustained.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Chanticleer Investment Company

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Chanticleer Investment Company, as assumer and/or transferee of Columbia Convalescent Home, against proposed assessments of additional franchise tax in the amounts of $828.01, $1,716.99, $1,747.51, and $1,719.37 for the income years ended March 31, 1967, 1968, 1969, and 1970, respectively, be and the same is hereby sustained with the understanding that appellant is entitled to refunds or offsets in the amounts of $698.00, $800.00, and $841.00 for the income years ended March 31, 1968, 1969, and 1970, respectively.

Done at Sacramento, California, this 7th day of January, 1975 by the State Board of Equalization.

John W. Lynch, Chairman

________________, Member

William M. Bennett, Member

George R. Reilly, Member

________________, Member

ATTEST: W. W. Dunlop, Secretary